STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF FINANCIAL EXAMINATION

of

OPTICARE OF UTAH

of

West Valley City, Utah

as of

December 31, 2001

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September 25, 2003

Honorable Merwin U. Stewart
Insurance Commissioner
State of Utah
3110 State Office Building
Salt Lake City, UT 84114

Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, an examination, as of December 31, 2001, has been made of the financial condition and business affairs of:

OPTICARE OF UTAH
West Valley City, Utah

hereinafter referred to in this report as the Organization, and the following report of examination is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered by Examination

The current examination covered the period from January 1, 1998, through December 31, 2001, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

A Certificate of Representation attesting to the Organization's ownership of all assets and to the nonexistence of unrecorded liabilities was signed by and received from the Organization's management at the conclusion of the examination.

Examination Procedure Employed

The examination included a general review and analysis of the Organization's operations, the manner in which its business was conducted, and a determination of its financial condition as of December 31, 2001. The examination was conducted in accordance with generally accepted standards and procedures of regulatory authorities relating to such examinations.

Status of Prior Examination Findings

The previous examination was performed by the Utah Insurance Department as of December 31, 1997. Adverse findings noted in the prior report of examination were addressed by the Organization or were identified as repeat exceptions in this report.

HISTORY

General

The Organization's articles of incorporation, filed on August 18, 1987, stated the Organization was organized under the Utah Business Corporation Act. It received a Certificate of Authority from the Utah Insurance Department to conduct an insurance business as a limited health plan pursuant to the Utah Code Annotated (U.C.A) Title 31A, Chapter 8 on January 4, 1988, to provide vision care benefits.

The stockholders of the Organization amended the bylaws by resolution on January 1, 2001, "to allow up to seven (7) directors." Number 2.2 of the General Interrogatories filed with the 2001 annual statement required "a certified copy of the instrument amended" to be furnished to the Utah Insurance Department. The amendment to the bylaws was not on file with the Utah Insurance Department. The Organization submitted the amendment to its bylaws to the Utah Insurance Department during the examination to comply with the NAIC *Annual Statement Instructions*. It also amended its articles of incorporation to allow up to seven (7) directors during the examination. The submission of the articles of incorporation was to comply with U.C.A. § 31A-5-219.

Capital Stock

The number of shares of common capital stock authorized by the Organization was 50,000 with a par value of $1.00 each as of December 31, 2001. The number of shares issued and outstanding was 23,530. Stephen H. Schubach, the controlling person, owned 85% of the issued shares of common capital stock.

Dividends to Stockholders

The Organization paid an extraordinary dividend in the amount of $479,045 to its shareholder on December 31, 2001, without receiving approval from the commissioner 30 days in advance. This was not in compliance with U.C.A. § 31A-16-106(2)(a).

Management

Directors serving as of December 31, 2001, were as follows (including location and principal occupation):

Name	Principal Occupation
Stephen H. Schubach Sandy, Utah	President Standard Optical Company
Mary McCarthy Salt Lake City, Utah	President Mary McCarthy, L.L.C.
Aaron R. Schubach Salt Lake City, Utah	Vice President Standard Optical Company

The Organization was not in compliance with U.C.A. § 31A-5-410(1). The commissioner was not notified immediately after the selection of one director Mary McCarthy during the examination period, and her biographical affidavit was not filed with the Utah Insurance Department as of December 31, 2001. The Organization submitted the biographical affidavit to the commissioner during the examination to comply with U.C.A. § 31A-5-410(1).

The Organization's bylaws provide for principal officers to consist of a president, a vice president and a secretary and a treasurer. The officers of the Organization as of December 31, 2001, were as follows:

Principal Officer	Office
Stephen H. Schubach	President
Aaron R. Schubach	Vice President
Klaus W. Rathke	Secretary
Kimberly Spratt	Treasurer

Conflict of Interest Procedure

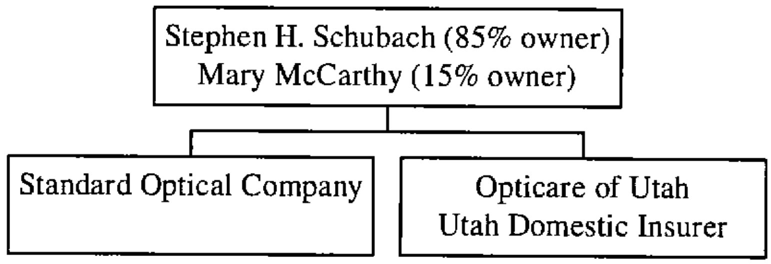
The Organization had no formal conflict of interest policy with an established procedure for disclosure of any material interest or affiliation that might influence a board member or officer in the performance of their duties. The directors and officers signed a conflict of interest statement on January 31, 1998, which covered the period of January 1995 through December 1997.

Corporate Records

The most recent board of directors (board) meeting was held on November 15, 2001, and the board approved the minutes of that meeting on July 22, 2002. There was no evidence to show the Organization complied with U.C.A. § 31A-2-204(8) by presenting the prior examination report to the board for their review.

AFFILIATED COMPANIES

The organizational chart below illustrates the holding company system:



Transactions with Affiliates

Effective August 19, 1987, the Administrative Services Agreement by and between the Organization and Standard Optical Company stated Standard Optical Company agreed to provide administrative services related to the operation of the Organization's Vision Care Services Plan, including, but not limited to, the following: general payroll and personnel services; accounting and annual statement services; auditing services; legal services; administration of sales; service to Enrolling Units and Enrollees and Family Dependents; agents' commission accounting; Contract Charge collection; accounting services relative to investments; establishing, maintaining and storing corporate records; and general office services. The agreement provided for compensation to the affiliate based on a percentage of monthly contract charges collected (premium) in the range of between 5% and 10%. The Organization paid the affiliate 10% of monthly contract charges collected.

Effective January 1, 2001, the Organization amended the Vision Care Plan Services Agreement by and between the Organization and Standard Optical Company. Pursuant to the original Vision Care Services Payment Schedule, the Organization agreed to pay the affiliate up to 80% of the contract charges collected. It added an appendix to the Vision Care Services Payment Schedule to have the Organization submit reimbursements to the affiliate of $25 each for products dispensed and services rendered. The Organization did not file a Form D Prior Notice of a Transaction with the commissioner 30 days in advance of the transaction pursuant to U.C.A. § 31A-16-106(1)(b)(iv). In addition, the Organization did not retain in its corporate records the original signed and executed agreement from 1987, which did not comply with Section 4.10 of its bylaws. The Organization amended the Vision Care Plan Services Agreement on December 13, 2002, and it filed a Form D along with the Form B Insurance Holding

Company System Annual Registration Statement. The reimbursement rate was increased to $30, effective July 1, 2002.

An Order to rescind the Organization's exemption from filing a Form B was issued on November 18, 2002. The commissioner determined the nature of the Organization's business had changed sufficiently, so the exemption was no longer justified. The Order instructed the Organization that, subject to U.C.A. § 31A-16-105(1)(b), within 15 days after the effective date of the Order, the Organization had to file its holding company registration with the Utah Insurance Department. The effective date of the Order was November 30, 2002. Therefore, the Organization was required to file the Form B by December 15, 2002, and any other required filings shall be filed subsequent to that date.

The analysis of the intercompany account confirmed the Organization was not in compliance with U.C.A. § 31A-16-106(1)(a). The transactions involving services were not considered to be arm's length according to SSAP No. 25(15), nor were they fair and reasonable, because the Organization continued to make payments to the affiliate substantially in excess of the terms of the billed charges. This was a repeat exception, because the noncompliance with U.C.A. § 31A-16-106(1)(a) was noted in the prior examination as of December 31, 1997.

FIDELITY BOND AND OTHER INSURANCE

The Organization was a named insured on a joint endorsement attached to the fidelity bond policy of its affiliate, Standard Optical Company. The minimum fidelity coverage suggested by the National Association of Insurance Commissioners (NAIC) for a limited health plan of the Organization's size and premium volume is not less than $50,000. As of the examination date, the Organization participated in fidelity bond coverage of $2,000,000. The Organization also had additional insurance protection against loss from business personal property and liability risks.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Organization did not have any pension, stock ownership, or insurance plans, because it did not have any employees.

STATUTORY DEPOSITS

The Organization's statutory deposit requirement was $30,000, pursuant to U.C.A. § 31A-8-211(1). The examination confirmed the Organization maintained a statutory deposit consisting of one U.S. Treasury Note with a cost of $56,682 and a par value of $57,000, which was adequate to cover the required deposit of $30,000.

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

There were five policy (enrollment) forms in use during the examination period: the Comprehensive Vision Care Plan for State of Utah Employees, the Basic and Premier Group Vision Plans, and the Basic and Premier Voluntary Vision Plans. The Organization did not comply with U.C.A. § 31A-21-201, because some of its enrollment forms in use were not filed with the commissioner.

Although the Organization's enrollment forms contained covered benefits, they did not contain a description of the Organization's method for resolving enrollee complaints, incorporating procedures to be followed by the enrollee in the event any dispute arises under the contract, including any requirements for arbitration. This was not in compliance with U.A.C. Rule R590-76-5(G). The Organization was able to identify other inconsistencies with the rule when it was asked to review the enrollment forms.

There was no underwriting risk, because the policies were guaranteed issue.

Territory and Plan of Operation

The Organization operated in the state of Utah. Its benefits included eye examinations, eyeglass frames, and lenses or contact lenses.

Number 7 of the 2001 General Interrogatories reported the Organization had 2 providers, and Number 10 listed the service area for the Organization as the state of Utah. These answers did not agree with the examination's findings. The Organization contracted with providers employed by Standard Optical located at nineteen different stores and three individual providers. The enrollees working and living outside of the state of Utah were utilizing providers who contracted with a third party administrator.

The Organization entered into an agreement with National Vision Administrators (NVA), a third party administrator during the examination period. The agreement was not available for review, but the examiner verified with NVA the Organization was listed as an enrolled group. NVA was not a licensed third party administrator in the state of Utah. According to U.C.A. § 31A-25-201(1), NVA may not perform any third party administration services in Utah without a valid license under Section 31A-25-203, including satisfying the nonresident jurisdictional agreement requirements under U.C.A. § 31A-25-206.

A licensed insurance agent, was hired by Standard Optical Company on December 11, 2000, to serve as the Organization's Director of Vision Plans, who concentrated on enrolling major employee groups represented by various brokers and agents, including employee leasing companies. The Organization had also contracted with 30 agents and agencies as of December 31, 2001, but certificates of appointment were not filed for those other 30 agents and agencies as required by U.A.C. Rule R590-101. Several certificates of appointment were filed in 2002.

Advertising and Sales Material

The Organization's advertising material included a benefits description of two of the plans offered by the Organization, the Group Vision Plan and the Voluntary Vision Plan. The material was distributed at Standard Optical Company stores and by the sales representatives of the Organization. The Organization had an advertisement in the Yellow Pages, and it listed its website address on its enrollment forms.

Treatment of Policyholders

The Organization had a written grievance procedure, however, it did not send its written grievance procedure to each enrollee at the time of enrollment pursuant to U.A.C. Rule R590-76-8. There were no formal complaints on file with the Utah Insurance Department.

Provider Contracts

The Organization did not comply with U.C.A. § 31A-8-407, because the contracts with its providers did not contain the hold-harmless provision to protect the enrollee in the event the Organization becomes insolvent.

REINSURANCE

The Organization had no reinsurance as of December 31, 2001.

ACCOUNTS AND RECORDS

The Organization's records were maintained and processed on the information systems belonging to its affiliate, Standard Optical Company. Standard Optical Company provided administrative services, which included joint use of personnel, property, equipment, and services to enable the Organization to conduct its business and other corporate functions. The Organization maintained a general ledger, receipts and disbursements journals, and other subsidiary records both manually and on personal computer equipment.

The Organization's general ledger was maintained on an accrual basis. The examiner footed the Organization's general ledger trial balance and reconciled it to the balance sheet and income statement expenses and surplus contained in the December 31, 2001 annual statement. Individual financial statement accounts for the years covered in the examination period were reviewed and reconciled as deemed necessary.

Item nine of the general section of the *Annual Statement Instructions* promulgated by the NAIC states, "If the report does not contain the information asked for in the blanks or is not prepared in accordance with these instructions, it will not be considered filed." In addition, U.C.A. § 31A-2-202(6) requires that "All information submitted to the commissioner shall be accurate and complete."

Many of the annual statement reports, exhibits and schedules were determined to be deficient or improperly prepared. Items of significance are listed below:

1. Schedule E Part 2 - Special Deposits was not completed in 2000 and 1999.

2. The total premiums reported in the 2001 Schedule T line 58 did not tie to Column 1, Line 9 of the Underwriting and Investment Exhibit - Part 1 as required by the NAIC *Annual Statement Instructions*.

3. The Organization did not comply with Section 5.03 of its bylaws, which required the board of directors to determine by resolution those persons authorized to sign checks.

4. The Organization did not submit an actuarial certification in the format prescribed by the NAIC *Annual Statement Instructions* with its 2001 annual statement filing. This was not in compliance with U.C.A. § 31A-4-113.5.

5. The Organization did not properly present the Claims Payable Aging Analysis of Unpaid Claims in the 2001 Exhibit 5 according to the NAIC *Annual Statement Instructions*, because the schedule included items greater than 30 days old.

6. The Organization recognized premium when it billed several accounts for more than one month's premium and reported it as Accident and health premiums due and unpaid, although the billing mode was monthly. Unearned premium reserves were not reported as required for premiums reported for a period beyond the date of valuation according to SSAP No. 54(12). The examination determined the liability to be approximately $2,600. The Organization should maintain its accounts and records properly so all liabilities are identified accurately. This was a repeat exception from the prior examination conducted as of December 31, 1997.

FINANCIAL STATEMENTS

The Organization's financial condition as of December 31, 2001, and the results of its operations during the twelve months then ended as determined by the examination are reported in the following financial statements:

BALANCE SHEET as of December 31, 2001

STATEMENT OF REVENUE AND EXPENSES for the Year Ended December 31, 2001

RECONCILIATION OF CAPITAL AND SURPLUS - 1998 through 2001

The accompanying NOTES TO FINANCIAL STATEMENTS are an integral part of the financial statements.

OPTICARE OF UTAH
BALANCE SHEET
as of December 31, 2001

ASSETS

	Net Admitted Assets	Notes
Cash and short-term investments	$ 154,423	
Accident and health premiums due and unpaid	45,336	(1)
Total assets	199,759	

LIABILITIES, CAPITAL AND SURPLUS

Claims unpaid	675	
General expenses due or accrued	61	(3)
Total liabilities	736	
Common capital stock	23,530	
Gross paid in and contributed surplus	46,470	
Unassigned funds (surplus)	129,023	(1), (2), (3), (4), (5)
Total capital and surplus	199,023	
Total liabilities, capital and surplus	$ 199,759	

OPTICARE OF UTAH
STATEMENT OF REVENUE AND EXPENSES
for the Year Ended December 31, 2001

OPERATING INCOME

	Total	Notes
Net premium income	$ 1,026,716	
Total revenues	1,026,716	

UNDERWRITING

	Total	Notes
Less:		
Total medical and hospital	697,553	
Claims adjustment expenses	4,675	
General administrative expenses	170,555	(3)
Total underwriting deductions	872,783	
Total underwriting gain or (loss)	153,933	

OTHER INCOME

	Total	Notes
Net investment income earned	3,068	
Net investment gains or (losses)	3,068	
Net income or (loss) before federal income taxes	157,001	
Federal and foreign income taxes incurred	0	
Net income (loss)	$ 157,001	

OPTICARE OF UTAH
RECONCILIATION OF CAPITAL AND SURPLUS
1998 through 2001

	1998	1999	2000	Per Exam 2001	Notes
Capital and surplus prior reporting year	$ 69,662	$ 103,127	$ 110,638	$ 120,146	
Net income or (loss)	34,555	132,657	303,358	157,001	(3)
Change in nonadmitted assets	(1,090)	(125,146)	(293,851)	375,921	(1), (2)
Capital Changes:					
Paid in				3,530	
Transferred from surplus (stock dividend)				479,045	
Surplus adjustments:					
Paid in				21,470	
Transferred to capital (stock dividend)				(479,045)	
Dividends to stockholders				(479,045)	
Rounding			1		
Net change in capital and surplus	33,465	7,511	9,508	78,877	
Capital and surplus end of reporting year	$ 103,127	$ 110,638	$ 120,146	$ 199,023	

NOTES TO FINANCIAL STATEMENTS

<u>(1) Accident and health premiums due and unpaid</u> <u>$45,336</u>

Accident and health premiums due and unpaid reported as of December 31, 2001, included prepaid expenses of $2,000. It was decreased by $2,000 to non-admit prepaid expenses to comply with SSAP No. 29.

The examination non-admitted accident and health premiums due and unpaid of $1,212, to comply with SSAP No. 6(9), because they were over 90 days past due.

<u>(2) Receivable from shareholder</u> <u>$ 0</u>

The Organization reported a $25,000 receivable from shareholder as of December 31, 2001. The receivable was not admitted for examination purposes, because it did not comply with SSAP No. 72(8).

<u>(3) General expenses due or accrued</u> <u>$ 61</u>

General expenses due or accrued was decreased by $3,262 to comply with the NAIC *Annual Statement Instructions*. The examination determined only $61 was due to creditors for goods and services provided in 2001.

<u>(4) Aggregate write-ins for other than special surplus funds</u> <u>$ 0</u>

The Organization improperly reported a negative write-in of $76,912 for Other than special surplus funds. This amount flowed through the capital and surplus account as part of the change in nonadmitted assets to arrive at the net unassigned funds (surplus) amount of $153,973 instead of the $230,885 reported. According to the NAIC *Annual Statement Instructions* for line 24, unassigned funds (surplus) is the undistributed and unappropriated amount of surplus.

<u>(5) Total capital and surplus</u> <u>$199,023</u>

The Organization's total capital and surplus was determined to be $24,950 less than reported in the Organization's annual statement as of December 31, 2001. The following schedule identifies the examination changes:

Description	Annual Statement Dr (Cr)	Per Examination	Change in Surplus Inc. (Dec.)	Notes
Accident and health premiums due and unpaid	$ 48,548	$ 45,336	$ (3,212)	(1)
Receivable from shareholder	25,000	-	(25,000)	(2)
General expenses due or accrued	(3,323)	(61)	3,262	(3)
Aggregate write-ins for other than special surplus funds	76,912	-	(76,912)	(4)
Unassigned funds (surplus)	(230,885)	(153,973)	76,912	(5)
Total examination changes			(24,950)	
Total capital and surplus per Organization			223,973	
Total capital and surplus per Examination			$ 199,023	

The Organization's minimum capital requirement was $20,000 as defined in U.C.A. § 31A-8-209. The Organization had total adjusted capital of $199,023 as defined by U.C.A. § 31A-17 Part 6, which exceeded the company action level risk-based capital (RBC) requirement of $101,388 by $97,635.

SUMMARY OF EXAMINATION FINDINGS

Items of significance commented on in this report are summarized below:

1. Amendments to the bylaws and articles of incorporation were not immediately filed with the commissioner. A certified copy of amendments to bylaws is required to be filed with the Utah Insurance Department to comply with the NAIC *Annual Statement Instructions*. Amendments to the articles of incorporation are subject to the requirements under U.C.A. § 31A-5-219. (HISTORY)

2. The Organization paid an extraordinary dividend in the amount of $479,045 to its shareholder on December 31, 2001, without receiving approval from the commissioner 30 days in advance. This was not in compliance with U.C.A. § 31A-16-106(2)(a). Dividends to Stockholders

3. The Organization was not in compliance with U.C.A. § 31A-5-410(1), when it did not immediately notify the commissioner of the election of one director and file the director's biographical affidavit. (Management)

4. There was no evidence to show the Organization complied with U.C.A. § 31A-2-204(8). (Corporate Records)

5. Two amendments were made to the Vision Care Plan Services Agreement by and between the Organization and Standard Optical Company without notifying the commissioner 30 days in advance of the transactions pursuant to U.C.A. § 31A-16-106(1)(b)(iv). (Transactions with Affiliates)

6. The Organization was not in compliance with U.C.A. § 31A-16-106(1)(a), because the transactions involving services were not considered to be fair and reasonable nor

were they arm's length according to SSAP No. 25(15). This exception was also noted in the prior examination as of December 31, 1997. (Transactions with Affiliates)

7. Several enrollment forms in use were not filed with the commissioner as required by U.C.A. § 31A-21-201. Also, enrollment forms filed for use were revised and used without filing the revised forms with the commissioner. (Policy Forms and Underwriting)

8. The enrollment forms did not contain a description of the Organization's method for resolving enrollee complaints to comply with U.A.C. Rule R590-76-5(G). (Policy Forms and Underwriting)

9. The Organization contracted with NVA, a third party administrator that was not listed in the Utah Insurance Department's database as a licensed third party administrator. According to U.C.A. § 31A-25-201(1), NVA may not perform any third party administration services in Utah without a valid license under Section 31A-25-203, including satisfying the nonresident jurisdictional agreement requirements under U.C.A. § 31A-25-206. (Territory and Plan of Operation)

10. Only one of thirty-one agents and agencies was appointed and authorized to conduct business on behalf of the Organization in Utah as of December 31, 2001. The Organization is required to file a "Certificate of Appointment" with the commissioner for all of its agents and agencies under U.A.C. Rule R590-101(4). (Territory and Plan of Operation)

11. Enrollees were not provided with the Organization's written grievance procedure pursuant to U.A.C. Rule R590-76-8. (Treatment of Policyholders)

12. Provider Contracts were not in compliance with U.C.A. § 31A-8-407, because they did not contain the hold-harmless provision to protect the enrollee in the event the Organization becomes insolvent. The Organization should revise the language in its contracts to include language set forth under U.C.A. § 31A-8-407(1)(a), specifically that if the Organization fails to pay for vision care services as set forth in the contract, the enrollee may not be liable to the provider for any sums owed by the Organization; and if the Organization becomes insolvent, the rehabilitator or liquidator may require the participating provider to provide vision care services covered under the contract for 90 days after the date of the filing of the insolvency petition or the date the term of the contract ends. (Provider Contracts)

13. Many of the financial statement line items and annual statement exhibits and schedules were determined to be deficient or improperly prepared. The annual statement should be prepared according to the NAIC *Annual Statement Instructions* to be considered filed, as stated in item nine of the general section. U.C.A. § 31A-2-202(6) requires all information submitted to the commissioner be accurate and complete. (ACCOUNTS AND RECORDS, NOTES TO FINANCIAL STATEMENTS)

14. The receivable from shareholder was not admitted, because the Organization did not comply with SSAP No. 72(8). (NOTES TO FINANCIAL STATEMENTS)

15. Total adjusted capital determined by the examination was $199,023, or $24,950 less than reported as of December 31, 2001. Total adjusted capital defined by U.C.A. § 31A-17 Part 6 exceeded the company action level RBC requirement of $101,388 by $97,635. (NOTES TO FINANCIAL STATEMENTS)

CONCLUSION

The assistance and cooperation extended during the course of the examination by officers, employees, and representatives of the Company is sincerely appreciated.

Respectfully Submitted,

Colette M Reddoor

Colette M. Reddoor, CFE
Utah Insurance Department